

Business Income and Taxes in Vermont

House Committee on Ways and Means

Ted Barnett

4/11/2023



JFO

1 Baldwin Street • Montpelier, VT 05633-5701 • (802) 828-2295 • <https://ljfo.vermont.gov>

Business Taxes In Vermont

- Vermont – like the Federal Government – treats taxes on net income/profit depending on how a business is structured
- Two Characterizations
 1. Pass-Through Businesses
 - Profits are divided amongst shareholders depending on shares of business
 - Owners of the business pay taxes through the Personal Income Tax Code
 2. Corporations
 - Subject to the Corporate Tax



Who Is a Pass-Through Business

- Pass-Through Business: Profits get “passed through” to owners who pay on their own personal income taxes
 - Sole Proprietors: Profits go to a single owner as their own income.
 - File a Schedule C
 - S-Corporations: Can have one or not more than 100 share holders.
 - Prohibited by law from being owned by another corporate entity
 - “S” stands for small business corporation
 - File Schedule E
 - Partnerships: two or more individuals own and operate a business. All partners have equal ownership rights.
 - File Schedule E



How Sole Proprietor Taxes Flow Through

Sole Proprietor

- 1 Owner
- \$100,000 in Profit



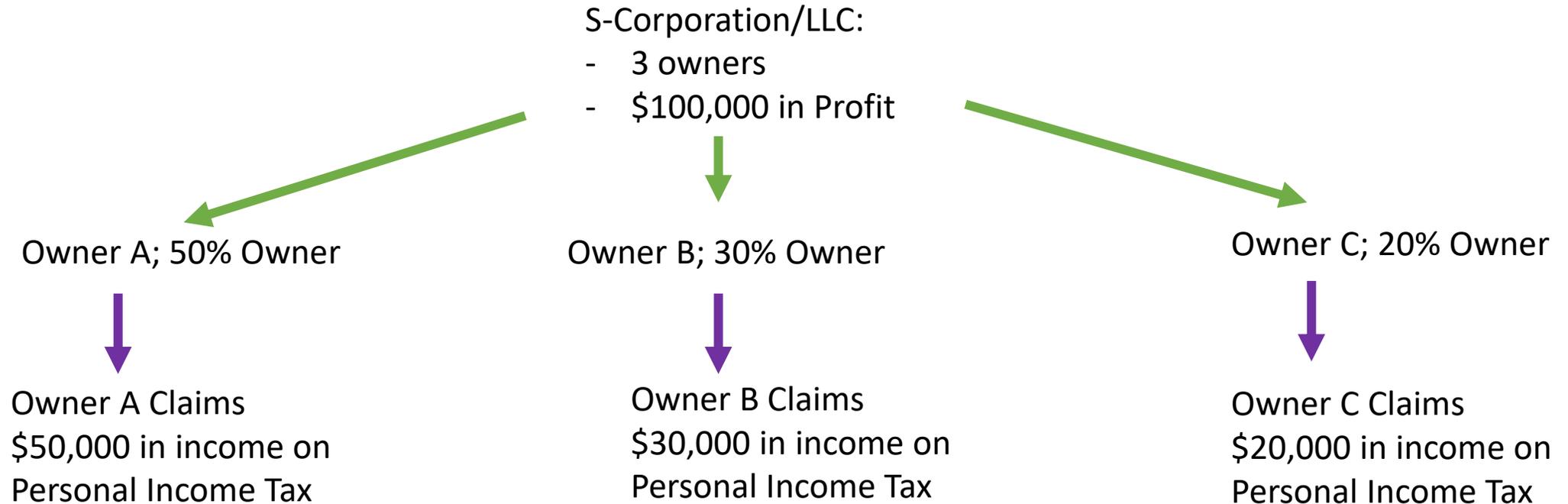
Owner 1 = 100%



Owner 1 Claims \$100,000 of
income on Personal Income Tax



How S-Corporation or LLC Taxes Flow Through



Business Structure and Taxation

- Corporations are a separate legal person, different than a natural person, which protects owners from lawsuits
 - As a result, corporations pay taxes at the entity level
- Pass-through businesses are not considered a separate entity
 - Owners take on a different and greater degree of liability
- Many more businesses structured as pass-throughs now
 - Complexity has spurred creation of entity-level filing requirements to assist tax administrators



Corporate Income Tax Tables

Tax Rates

Marginal Tax Rates (Effective Beginning with Tax Year 2007):

Allocable to VT	Base Tax	Plus	of Amt. Over
\$0 - 10,000		6.00%	\$0
\$10,001 - 25,000	\$600	7.00%	\$10,000
\$25,001 - and more	\$1,650	8.50%	\$25,000.00

Gross Receipts	Minimum Tax
\$0-\$500,000	\$100
\$500,001 - \$1 million	\$500
\$1 million - \$5 million	\$2,000
\$5 million - \$300 million	\$6,000
Greater than \$300 million	\$100,000

Source: Vermont Department of Taxes



Tax Comparison: Pass-Through and Corporate Filer

Box 1: 2023 Vermont Taxes on \$500,000 in Net Business Profits: Pass-through vs C-Corporation		
	C-Corporation	Sole-Proprietorship
Marital Status (married)		
Net Income	\$500,000	\$500,000
Taxes		
Corporate Income Tax (entity level)	\$41,800	Not Applicable
Personal Income Tax (owner/shareholder level)	\$31,260	\$34,918
of which: Business Income	\$0.00	\$34,918
of which: Dividends	\$31,260	\$0.00
Total Vermont Taxes	\$73,060	\$34,918
Effective VT Tax Rate Net Business Income	15%	7%



S.45 Splits the Difference

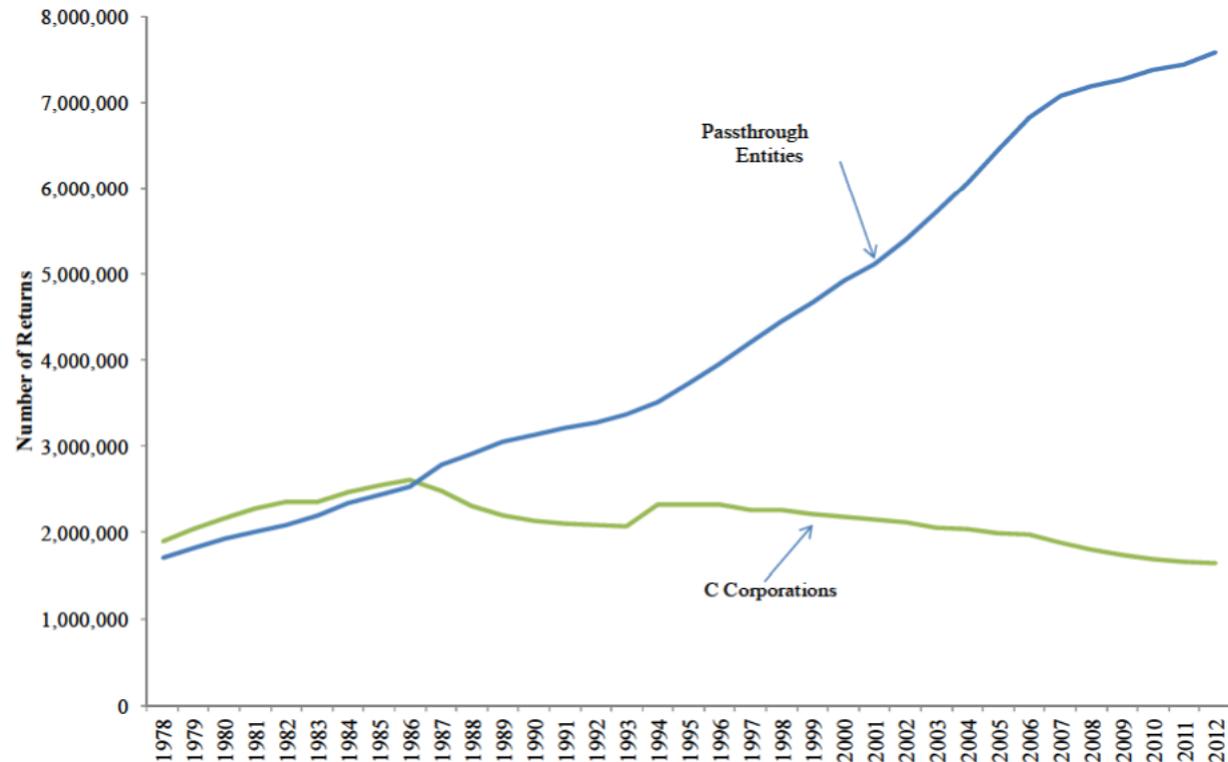
- By creating a Pass-Through Entity (PTE) Tax, which is paid at the entity level, S.45 would treat pass-through businesses more like c-corporations, which are also taxed at the entity level
- But the 90% PTE tax credit in S.45 means that pass-through businesses owners would pay far less personal income tax
- Adjusting the size of the PTE tax credit in S.45 would change the amount of personal income tax paid by pass-through business owners
 - For example, decreasing the credit increases the effective rate paid by pass-through business owners



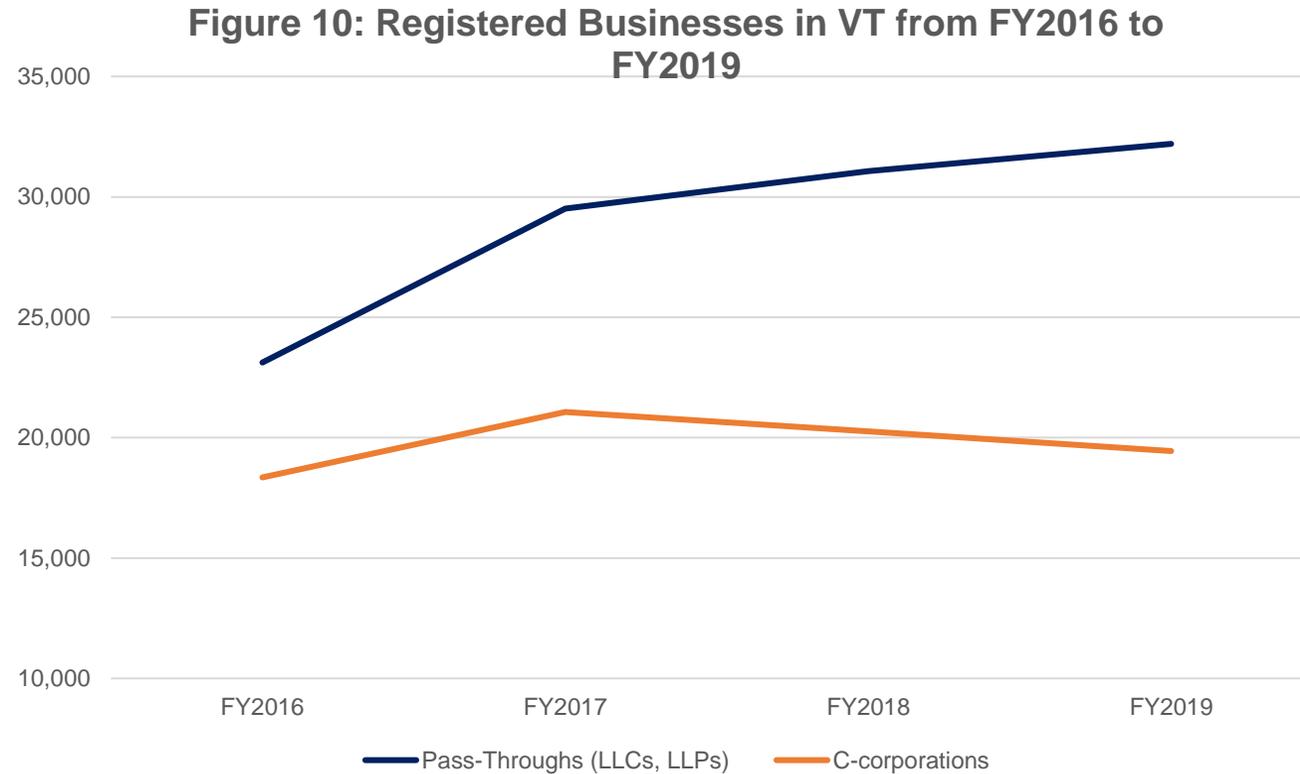
Business Status at the National Level

Figure 2.—Number of C Corporation Returns Compared to the Sum of S Corporation and Partnership Returns, 1978-2012

- Pass-throughs proliferated after 1986 Tax Reform by Reagan Administration, which greatly reduced personal income tax rates



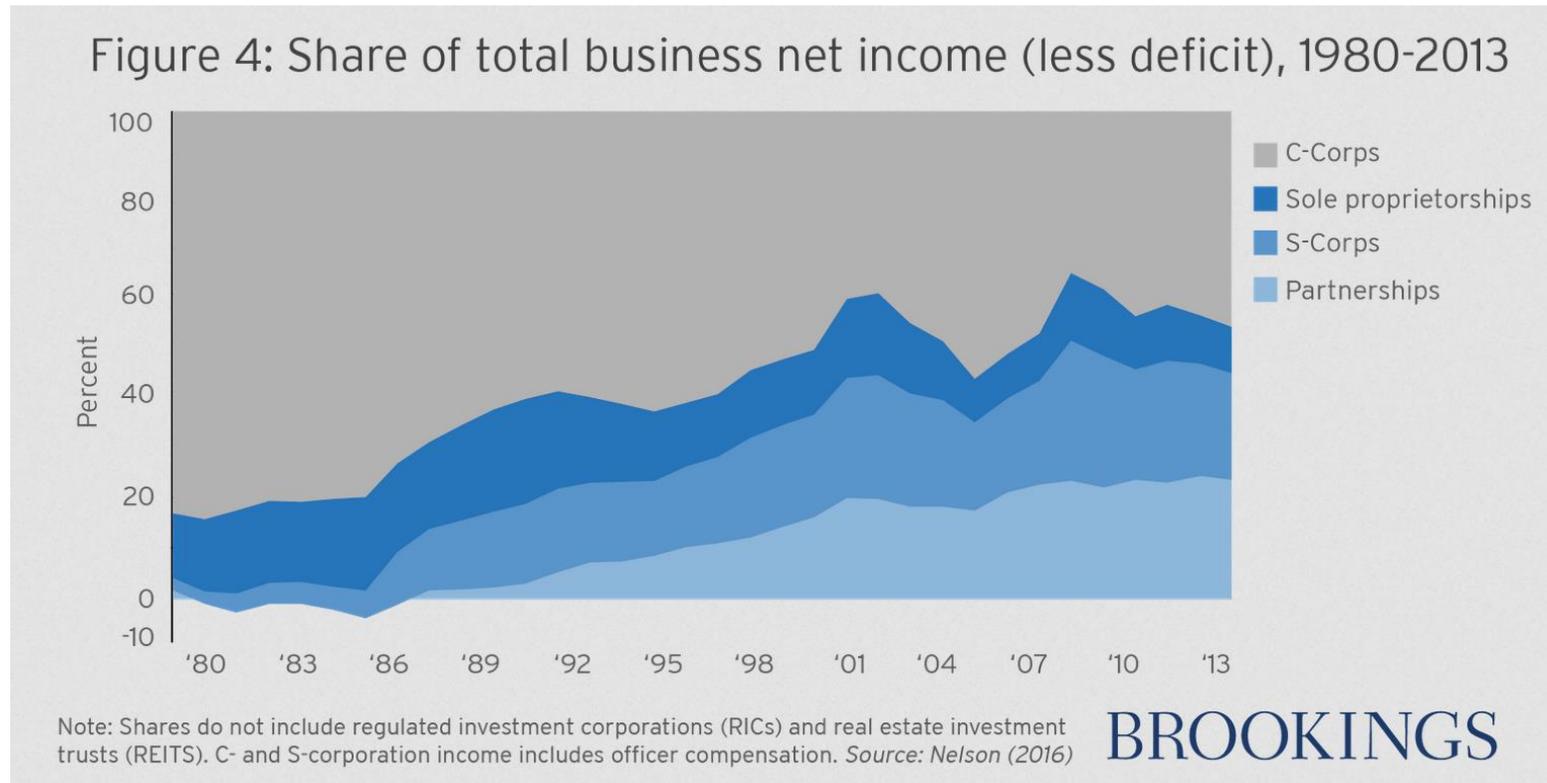
Business Status in Vermont



Note: Includes foreign and domestic pass-throughs and corporations. Does not include non-profit businesses
Source: Vermont Secretary of State



National Business Net Income Since 1980

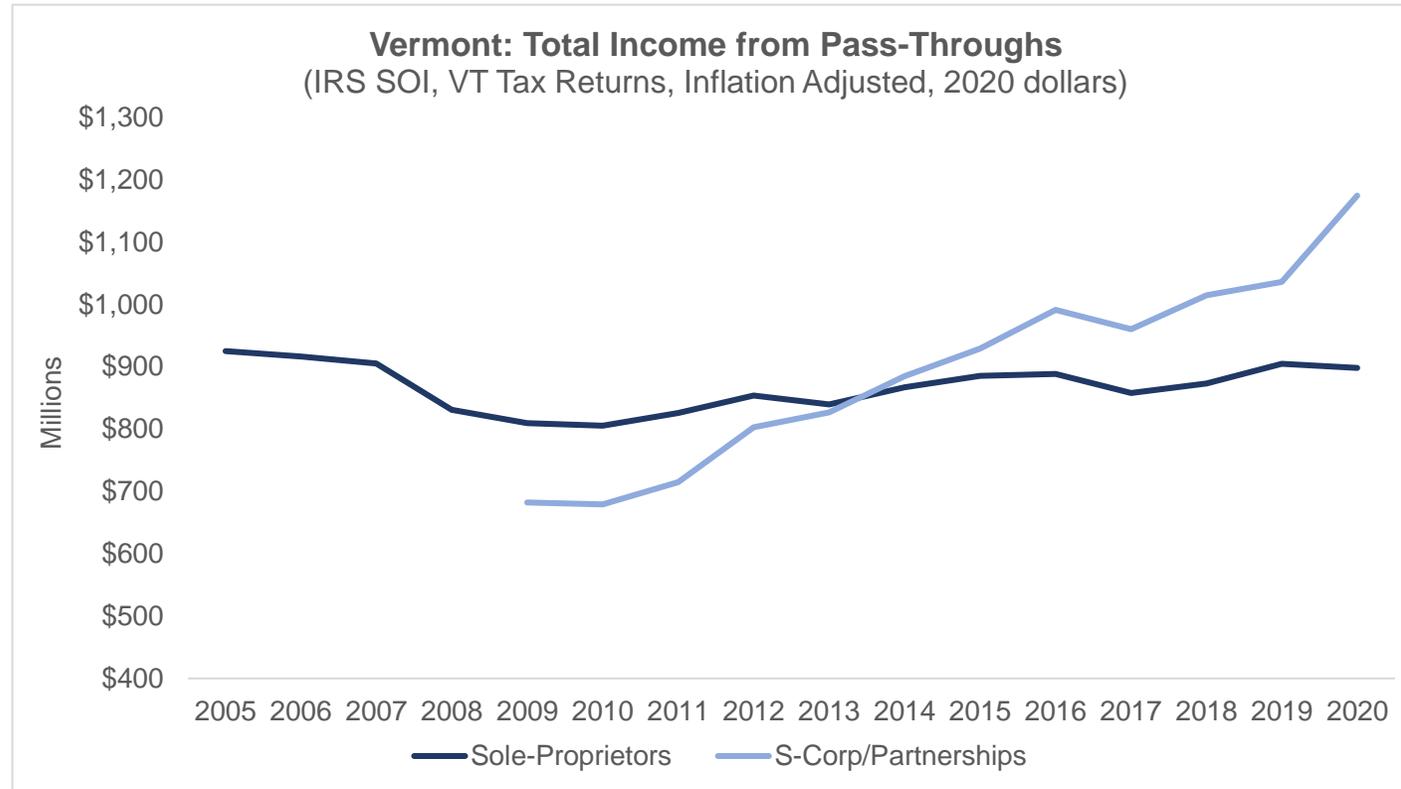


Source: Brookings Institute "9 Facts about pass-through businesses" <https://www.brookings.edu/research/9-facts-about-pass-through-businesses/>

- Pass-through income as a share of total net business income has increased substantially
- Increase in share of S-Corp and Partnership net income primary cause of this change



Passthrough Income on Vermont Tax Returns



Source: IRS SOI Historical Tables, VT Tax Returns - Inflation Adjusted using PCE index to 2020 dollars

- Sole-proprietor income has stayed relatively constant since 2005, while S-Corp/partnership income has increased substantially

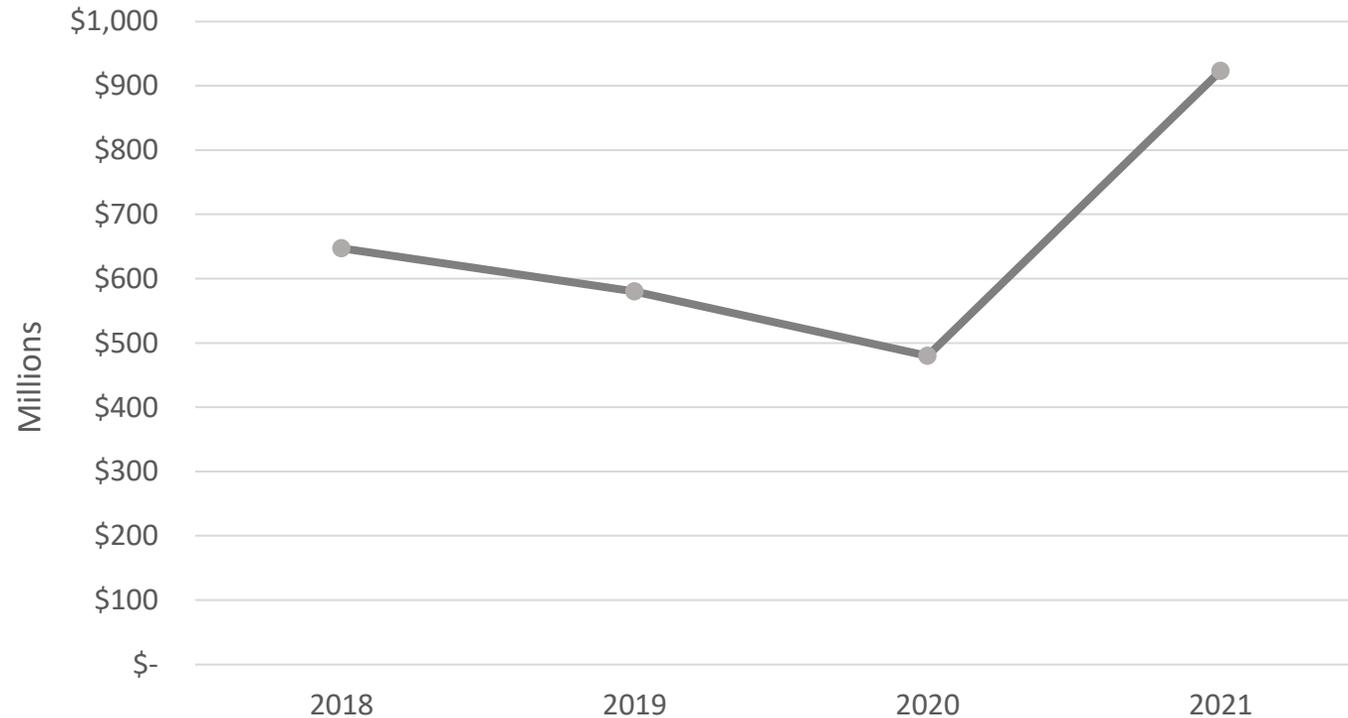


Pass-Through Summary

- In 2019, 58,580 VT resident returns reported \$895 million in sole-proprietorship business income
 - Represents 4% of total Vermont AGI on income tax forms
- In 2019, 20,500 VT resident returns reported \$1.0 billion in s-corporation/partnership income
 - Represents 4.6% of total Vermont AGI on income tax forms
- JFO Pass-through Issue Brief estimated that in FY 2020, pass-through returns generated at least \$110 million in Vermont personal income tax revenue
 - Represents about 12% of personal income tax revenues
 - An estimated 6.7% of available General Fund revenues in FY 2020



Corporate Net Income in Vermont



Source: Vermont Department of Taxes

- Net corporate income is volatile – and in 2019 was about a third of total pass-through net income
- Corporate Income Tax revenues represented 6.5 to 9 percent of available General Fund revenue between 2018 and 2021



Vermont Sole-Proprietor Income Distribution

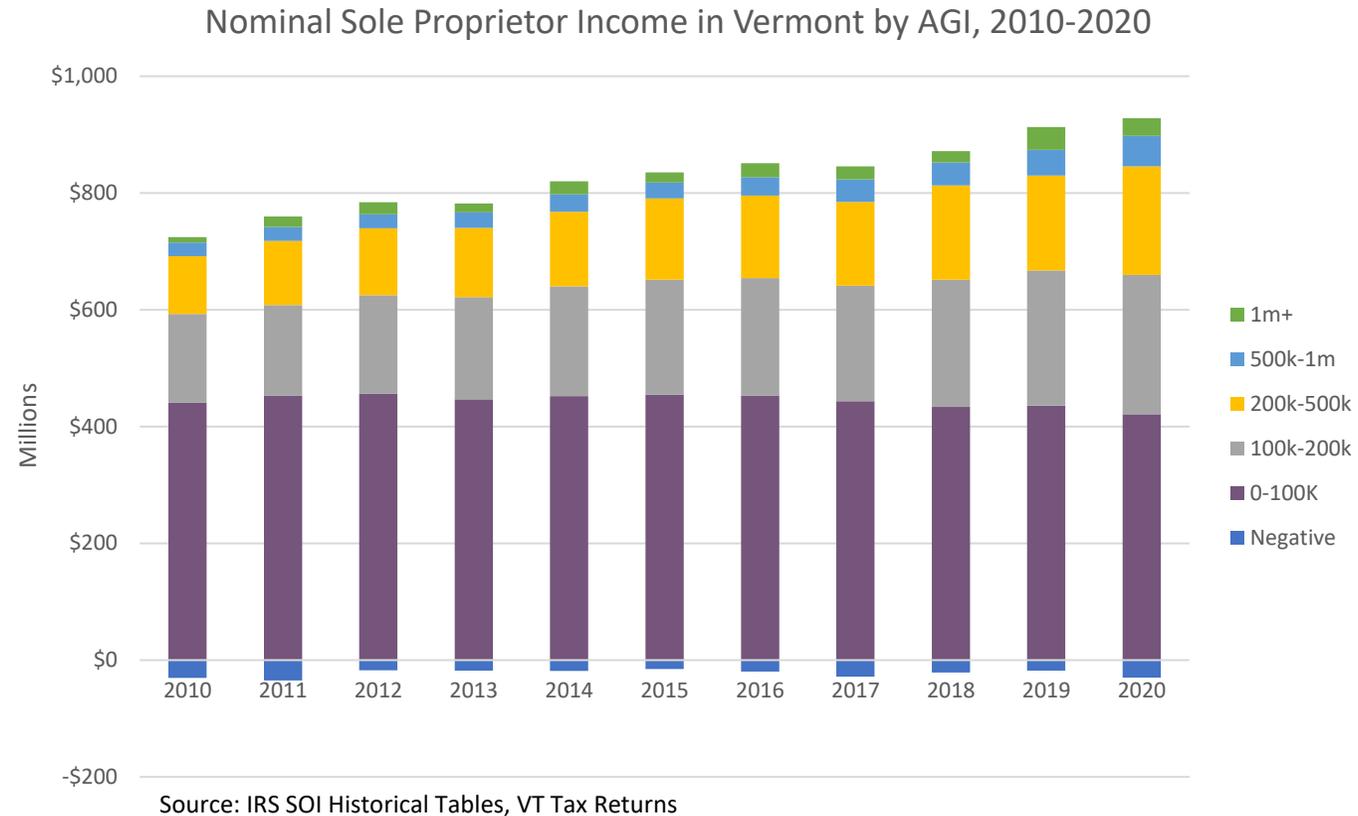
2019 AGI	Number of Returns	Net Income Reported (millions \$)
Negative	2,000	-\$17.8
\$1 under \$100,000	41,330	\$436.0
\$100,000 under \$200,000	10,780	\$231.3
\$200,000 under \$500,000	3,430	\$162.3
\$500,000 under \$1m	510	\$44.0
\$1m or more	180	\$39.3
Total	58,220	\$895.1

Source: IRS SOI Historical Tables

- Almost half of net income reported in 2019 by returns with sole-proprietorship income was reported by filers with less than \$100K in AGI
- 70% of total returns had less than \$100K in AGI



Vermont Sole-Proprietor Income by AGI



- Share of sole-proprietor income reported by different income brackets has stayed relatively constant in nominal terms since 2010



S-Corp/Partnership Income Distribution

AGI Group	Number of Returns	Net Income Reported
Negative	920	-\$70.9
\$1 under \$100,000	8,840	\$70.0
\$100,000 under \$200,000	5,640	\$146.4
\$200,000 under \$500,000	3,700	\$286.0
\$500,000 under \$1m	910	\$210.6
\$1m or more	490	\$382.8
Total	20,500	\$1,024.8

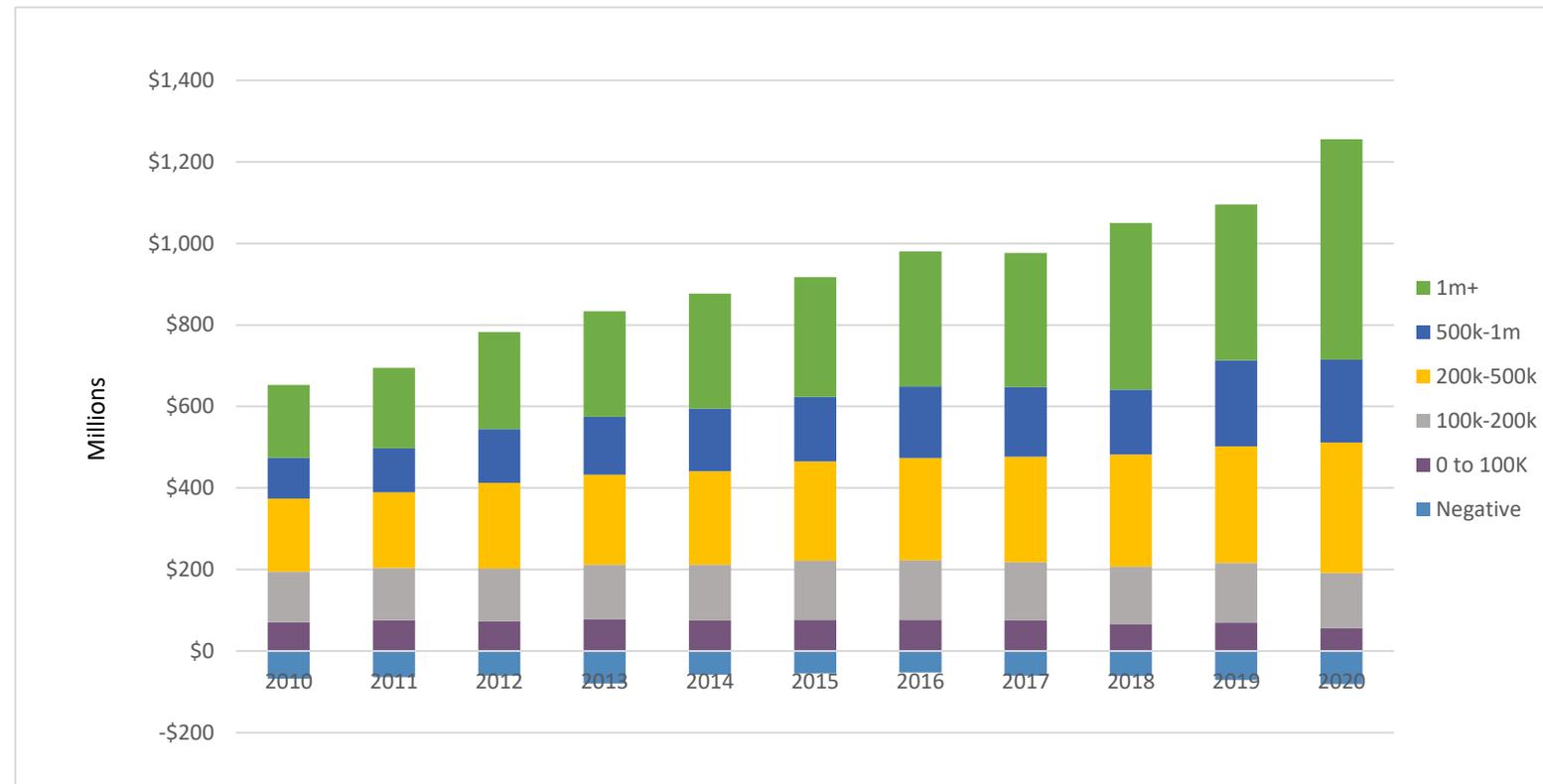
Source: IRS SOI Historical Tables

AGI Group	Number of Returns	Net Income Reported
Under \$500,000	19,100	\$431.5
\$500,000 or more	1,400	\$593.4
Total	20,500	\$1,024.8

- S-Corp/Partnership net income more unevenly distributed
- More than half of net income of this group held by filers reporting more than \$500K in AGI despite representing less than 7% of returns with this type of income



S-Corp and Partnership Income by AGI



- The amount of S-Corp/Partnership income has increased from \$585 million to more than \$1 billion by 2019 (in nominal terms), while the number of returns has stayed constant
- Amount of income reported by filers with an AGI of more than \$1 million has increased by the largest amount, especially in 2020



Summary

- Most pass-throughs are small and most pay very little tax on their profits, if any.
- The tax base, however, is driven by a very small number of very large and/or profitable pass-throughs
- The number of pass-through businesses and amount of income generated by these businesses has increased sharply in the past 30 years
- Passthrough income returns, with the exception of the most profitable pass-throughs, benefit from the discrepancy between personal income tax rates and corporate income tax rates.
- Specifically targeting pass-through owners in a tax proposal is difficult because of the way their income is weaved into AGI.
 - Any changes to tax rates will impact effective tax rates on pass-through businesses
 - A change to the highest brackets would be more targeted because most pass-through income accrues to high-income individuals.



Questions?

